# PROFIT SYSTEMS IN MILITARY NONAPPROPRIATED FUND ACTIVITIES

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# CHAPTER I

## INTRODUCTION

A business enterprise provides goods or service to the public and in return receives revenue. The excess of revenue over total cost is called profit. This profit may be distributed to the owners of the enterprise or retained within the business to produce profit in the future. This is the familiar model of a business or private enterprise.

There are activities in the Federal Government which operate much like private enterprise. They sell merchandise and service to a group of patrons and create a profit from the resulting revenue. These activities do not declare dividends, but instead furnish resource support to other activities of the government out of their profits. This is an area of government that is little known to the public.

One of the best examples of these profit producing and profit consuming systems in the Federal Government is the group of activities known as the military nonappropriated fund activities of the Armed Forces.

### Purpose and Scope of the Study

The purpose of this study is to describe the major profit systems in military nonappropriated fund activities of the armed forces with particular emphasis on the differences among the services, and to evaluate the impact of these differences. This will be done by developing a general descriptive model

of nonappropriated fund activities and then describing the major profit system activities of each service in particular.

The general descriptive model will not be complete in describing all nonappropriated fund activities of the services. Rather, it will be limited to providing a background and basis for the more detailed description of specific activities later in the paper.

The description of specific activities will not include all the profit system activities, but only the more important ones of the Army, Navy, Air Force and Marine Corps.

## Limitations

The evaluation of systems will necessarily be general and subjective. There is no adequate quantitative basis on which the systems of the various services can be compared. There are two reasons for the inadequacy:

1. The functions and areas of activity of the profit system activities differ among the services. A profit producing activity in one service may be a profit consuming activity in another, or a profit consuming activity in one service may be entirely outside the system as a self sustaining activity in another service. These areas of inconsistency are pointed out in succeeding chapters.

2. In the past, nonappropriated fund activities have been criticized for competing with private enterprise. Officials of nonappropriated fund activities are dedicated and believe in the worth of their activities, therefore they are understandably reluctant to discuss detailed financial data except at the urging of highly placed authorities. Further, much of the information that would be necessary for a quantitative comparison simply is not gathered or compiled in the normal course of activity.

## Organization of the Study

Chapter II of this study develops the general descriptive model of nonappropriated funds in the military services. This chapter discusses the general characteristics, history, and legal status of nonappropriated fund activities in general, and describes the basic operation of profit system activities.

Chapter III discusses the major profit system activities of the Army and the Air Force. These include the Army and Air Force Exchange Service, the Army and Air Force Motion Picture Service, and the Army and Air Force military welfare funds. In describing these activities this chapter provides a point of departure for the discussion of Navy and Marine Corps systems in subsequent chapters.

Chapter IV discusses the Navy exchange system, ship's stores, and the Navy recreation funds.

Chapter V discusses Marine Corps exchanges, the attendant Marine Corps Exchange Service and Marine Corps Exchange Fund, and the recreation funds of the Marine Corps.

Chapter VI evaluates the systems discussed in previous chapters by comparing some of their salient features and draws some conclusions from the study.

## CHAPTER II

## NONAPPROPRIATED FUND ACTIVITIES: A GENERAL MODEL

### What Are Nonappropriated Fund Activities?

There are formal definitions of nonappropriated fund activities provided by each of the services.[1] These definitions and other provisions of regulations suggest the following common characteristics of all nonappropriated fund activities:

1. All nonappropriated fund activities are operated for the benefit of military or civilian personnel of the services.

2. They are supported at least in part by funds that are not appropriated by the Congress, hence the term "nonappropriated funds."

3. They are not incorporated or chartered by any government, yet they have a distinct legal status. Their legal status will be discussed later in this chapter.

4. Their assets are property of the Federal Government. No individual unit, or organization has a proprietary interest in the assets.

5. They derive their nonappropriated funds from the sale of merchandise and service, or from dues and fees.

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[1]For example, see U.S., Army, Nonappropriated Funds and Related Activities: General Policies, Army Regulations No. 230-5, July 18, 1956, para. 3 and changes. Referred to hereafter as AR 230-5. This definition applies specifically to the Army, but it is typical of all the services.

6. They operate with official sanction under command supervision. In this respect, they are functions of command, having derived their authority either directly from the secretary of the service or from authority delegated down the chain of command from the secretary.

There is a wide diversity of nonappropriated fund activities in the military services. They include the familiar "P.X.," officers' club, noncommissioned officers' club, and recreation fund with which every ex-serviceman is familiar, plus some which are not so familiar such as post restaurants, book stores, flying clubs, and a host of hobby and sporting clubs.

Generally, nonappropriated fund activities round out the military community where appropriated funds do not provide for the complete functions of a normal society. Frequently, this involves providing diversified wholesome outlets for the free time of the serviceman, but in some cases the nonappropriated fund activity contributes more directly to military functions. For example, exchanges (P.X.'s) provide basic items of necessity to the serviceman. Also, the recreation program supported out of nonappropriated funds is usually a large factor in the health and physical fitness of military personnel. As a result of this overlapping into military areas, nonappropriated funds have a significant role in the operations of the Armed Forces even though their volume does not approach that of appropriated funds.

Nonappropriated funds and their activities[2] can be classified on the basis of the source and disposition of their funds:

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[2]The term "fund" is sometimes used interchangeably with "activity". Thus a recreation fund may denote not only a group of resources but the activities which the resources support just as the Fund for the Republic is an organization with identifiable activities as well as a grouping of financial resources.

1. Profit producing activities are intended to provide merchandise or services and in so doing create a profit which is used to support profit consuming activities. This classification is synonymous with "revenue producing funds" as officially recognized in the Army[3] and the Air Force.[4] The exchanges are the giants within this classification, but it also includes Navy ship's stores, the Army and Air Force Motion Picture Service, book stores, restaurants, and cafeterias.

2. Profit consuming activities receive support from the profit producing activities. In some cases, they may have substantial income producing functions within them, but as a whole, they are not expected to produce profits. Their general purpose is to provide free time recreation for military and civilian personnel. There are two types of profit consuming activities: civilian and military. Civilian activities receive support from such profit producing activities as restaurants and cafeterias which are primarily intended for use by civilians. The military activities are supported by the exchanges, ship's stores, and the Army and Air Force Motion Picture Service. Civilian profit consuming activities are called civilian welfare funds in all the services. Military profit consuming activities are called welfare funds by the Army and Air Force, and recreation funds by the Navy and Marine Corps.

3. Sundry activities are self supporting and financially independent of other nonappropriated fund activities. While the activities of the profit pro-

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[3]AR 230-5, para. 4.

[4]U.S., Air Force, Nonappropriated Funds: Nonappropriated Funds and Related Activities, Air Force Regulation No. 176-1, Sept. 10, 1957 and changes, para. 2.

ducing and profit consuming funds are open to all military personnel, the activities of sundry funds may be limited to specific personnel, e.g., a noncommissioned officers' open mess (NCO club) is available only to noncommissioned officers. The basis of participation may be rank, similarity of interests, or simply the payment of dues or fees. In some cases, there may not be any limitation on participation.

4. Unofficial activities are a large group of private associations or public institutions which operate at military activities and are frequently thought of and treated as nonappropriated fund activities. Occasionally, there are activities such as wives' clubs that do not have official sanction or supervision but are accorded the privilege of operating on a military installation. In other cases, there may be activities such as a bank or the Red Cross which fulfill a function on an installation, but whose activities are not completely under the control of the military service. These activities will not be considered in this paper because they have no bearing on the profit systems which are the subject of the study.

The classification of activities outlined here is not intended to provide a perfect system of classification. This is not within the scope or purpose of this paper. Rather, it is intended only to point out the importance of the profit relationship to nonappropriated funds.

## History

The history of nonappropriated funds in the military is largely the history of the post exchanges and ship's stores.[5] Up to the late nineteenth

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[5]For a detailed discussion of the history of nonappropriated funds in the Army see Paul J. Kovar, "Legal Aspects of Nonappropriated Fund Activities," Military Law Review, Department of the Army pamphlet 27-100-1 (Sept., 1958), pp. 95-136.

century, the needs of American military personnel were met by civilian private entrepreneurs known as sutlers and post traders ashore or bumboaters at sea. These private businessmen operated under varying degrees of official sanction and regulation. Evidently, their services were not satisfactory, for Army units on the frontier began to form cooperative stores known as canteens to take the place of the traders. These cooperatives were officially recognized and organized into post exchanges in 1895 by order of the Secretary of War.[6] In 1900 the Marines established post exchanges in the Phillipines,[7] and in 1909 the Naval Appropriation Act approved the establishment of ship's stores.[8] Thus, by 1910 the pattern of the post exchange and the ship's store was established in all the services. These sale activities provided merchandise and services to military personnel at reasonable prices. Their line of merchandise was usually typical of the general store of the day. Profits were distributed back to the personnel who patronized the stores in the form of recreation and welfare programs for the general good. These activities were highly localized and in some instances were even duplicated in the various units at a single post. Control and supervision of the system was largely up to the individual commander.

This system would not support the influx of personnel drawn into the services for World War I. Such organizations as the Salvation Army and the Y.M.C.A. filled the breach with canteens that provided organized recreation for

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[6]John J. Ryan, Selling the Armed Forces Consumer Market (Washington, D.C.: Army Times Publishing Co., 1957), p. 37.

[7]Ibid.

[8]U.S., Navy, "United States Naval Administration in World War II: Bureau of Supplies and Accounts, Ship's Store Division" (an unpublished typewritten first draft narrative prepared under general supervision of the Director of Naval History, 1945), p. 1.

the troops and a measure of their material needs.[9] The activities of these organizations were coordinated by two President's Commissions on Training Camp Activities, one for the Army and one for the Navy. Both commissions were chaired by Raymond B. Fosdick. At the end of the war, Mr. Fosdick recommended that the activities which had been provided under his commissions should be continued under the services themselves.[10] The adoption of these recommendations was the first official recognition of the need for recreational facilities on a service-wide basis and marked the beginning of appropriated fund support of these activities.[11] This was the basis for the current arrangement between the exchanges as the producers of profit and the recreation activities as the consumers.

During World War II, both the exchanges and the recreation activities were expanded to meet the requirements of mobilization. This expansion resulted in changes in structure, departing from the traditional orientation of the profit system at the local command level, and was responsible for differences in profit systems among the various services which will be explored at length in this paper.

After World War II, the services' nonappropriated fund activities were the subject of substantial interest by the public, Congress, and the Federal Government. The bulk of this interest centered around the exchanges and their competition with private retail enterprise.

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[9]For an interesting non-technical background description of these activities in France see Marion Baldwin, Canteening Overseas (New York: The MacMillan Co., 1920).

[10]Report to the Commandant of the Marine Corps by the Chairman of the Ad Hoc Committee on Nonappropriated Fund Activities of the Marine Corps, December 26, 1961 (in the files of Headquarters United States Marine Corps, Washington, D.C.), Tab B, pp. 5-6.

[11]Ibid., Tab B, p. 6.

In 1949, the Philbin subcommittee of the House Armed Services Committee investigated the exchanges. This investigation concluded that the exchanges were in fact competing unduly and unfairly with private enterprise. No legislation resulted, but the Department of Defense came to an agreement with the Committee on remedial action that resulted in the Armed Services Exchange Regulations prescribed by the Secretary of Defense.[12] These regulations made a number of important restrictions on the operations of exchanges which now serve as the common basis for their operation in all the services. The most important provisions were:

1. The patrons authorized to purchase from exchanges were clearly defined. Procedures for identifying patrons were spelled out.[13] This was intended to satisfy the complaint of private retailers that the exchanges were in fact being used by a large patronage not connected with the military.

2. The merchandise and services authorized for sale were clearly spelled out. Many items of merchandise were assigned a maximum invoices price.[14]

3. Systematic audits and inspections were prescribed.[15]

4. Limitations were placed upon the use of appropriated funds to support exchanges. Generally, nonappropriated funds were required to support all operations of the exchanges except the cost of real property and its normal maintenance. Minimal military personnel paid from appropriated funds for supervision

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[12]U.S., Congress, House, Subcommittee on Defense Activities of the Committee on Armed Services, Report on Armed Services Exchanges (PX's), 1953, 83d Cong., 1953, pp. 1-4.

[13]U.S., Department of Defense, Armed Services Exchange Regulations, January, 1956, para. 2-110 - 2-304.

[14]Ibid., para. 3-101 - 3-302.

[15]Ibid., para. 4-201 - 4-202.

were permitted.[16] These limitations were intended partially to close the gap between the prices charged in exchanges and those charged by civilian retailers.

The Armed Services Exchange Regulations have been revised and republished since 1949, but their content and purpose remain substantially unchanged. They are the common denominator of profit system nonappropriated fund activities in all the services.

In 1953, civilian retailers represented by the National Retailers Federation complained again to Congress about the exchanges. This time the complaint centered upon allegations that the services were not following the Armed Services Exchange Regulations.[17]

The Subcommittee on Defense Activities of the House Armed Services Committee looked into the charges. In essence, the Subcommittee concluded that the charges against the exchanges were based on isolated instances but were not indicative of substantial violations. In making its findings, the Subcommittee reinforced the need for exchanges both from the standpoint of providing necessary merchandise and service to service personnel and from the standpoint of providing support to other activities through profits. The Subcommittee recognized that these activities would have to be supported by appropriated funds were it not for profits from exchanges.[18]

The Commission on Organization of the Executive Branch of the Government (second Hoover Commission) studied exchanges and other nonappropriated fund activities in connection with its investigation of government business enterprises.

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[16] Ibid., para. 4-601 - 4-602.

[17] Report on Armed Services Exchanges (PX's), 1953, p. 5.

[18] Ibid., pp. 7-10.

This study approached the problem with the basic philosophy that all government business enterprises which could be replaced by private enterprise were undesirable.[19] Further, the Commission seemed to believe that all costs of exchanges should be covered in the sale price of merchandise.[20] In this connection the Commission made these recommendations to Congress:

1. that the exchanges be limited to isolated areas where adequate civilian facilities were not available,

2. that prices in exchanges be made adequate to cover all costs,

3. that items which were not necessities be eliminated from exchanges,

4. that no military personnel except supervisorypersonnel be used in exchanges,

5. that consideration be given to contracting out the operation of exchanges, and

6. that the Comptroller General make a complete survey of exchanges.[21]

These recommendations apparently fell on deaf ears in Congress, for there is no indication of any action being taken on them. This is not surprising. Most of the matters covered by the recommendations had been covered by the investigations of the House Armed Services Committee in 1949 and 1953, when they were resolved to the Committee's satisfaction. Further, the Commission's interpretation of the will of Congress was opposed to that expressed by the Subcommit-

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[19]U.S., Subcommittee on Business Enterprises, Committee on Business Organization of the Department of Defense, Commission on Organization of the Executive Branch of the Government, Subcommittee Report on Business Enterprises of the Department of Defense, June, 1955, p. 1.

[20]Ibid., p. 46.

[21]U.S., Commission on Organization of the Executive Branch of the Government, Business Enterprises, May, 1955, pp. 20-2.

tee on Defense Activities in the 1953 report.[22]

The second Hoover Commission also recommended to Congress that it look into clarifying the legal status of nonappropriated fund activities and their employees.[23] This was a well founded recommendation, but there appears to have been no action taken on it.

## Legal Status

Nonappropriated fund activities are unquestionably instrumentalities of the Federal Government and therefore are entitled to all the immunities accorded the Federal Government under the Constitution.[24] The simplicity of their status ends there, however.

In contracts, opinion is divided as to whether the government or the nonappropriated fund activity is the proper plaintiff in the event of breach by the activity.[25] In torts, the most recent decisions seem to indicate ". . . that nonappropriated fund activities, as separate and distinct entities, have no liability to third parties for torts committed by their employees since suits within the limits of the Federal Tort Claims Act may be filed against the United States."[26]

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[22]Report on Armed Services Exchanges (PX's), 1953, pp. 8-10.

[23]Business Enterprises, pp. 22-6.

[24]Kovar, Military Law Review, p. 112. In addition to being an excellent discussion of the history of Army nonappropriated fund activities as previously mentioned, this article is also a comprehensive discussion of the legal status of all nonappropriated fund activities.

[25]Ibid., pp. 123-26.

[26]Ibid., p. 128.

Federal taxes as a general rule are not applicable to nonappropriated fund activities. There are exceptionsto the rule, however. The Federal Manufacturers' Excise Tax and Federal Retailers' Excise Tax must be paid and collected by exchanges because of specific language in the statute and the interpretation of the Internal Revenue Service. Nonappropriated fund activities withhold from the wages of their employees for Federal income tax and for Social Security. The all important Federal income tax on profits is, of course, not applicable to nonappropriated fund activities.[27]

As a general rule, nonappropriated fund activities are exempt from state taxation. The exceptions to this are few, and they are based upon specific Federal legislation. State taxes may be levied on motor fuels sold in military exchanges where the fuels are not for the exclusive use of the United States. In some cases nonappropriated fund activities must withhold from employees wages for state income taxes.[28]

In 1952, Congress passed an act which clarified somewhat the status of employees of nonappropriated fund activities. This act provided that while such employees were not considered to be employees of the United States for the purpose of laws administered by the Civil Service Commission or the provisions of the Federal Employees Compensation Act, they would be covered by insurance or otherwise with compensation for death or injury in a manner comparable to that provided by the laws of the state in which employed.[29]

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[27] Ibid., pp. 115-18.

[28] Ibid., pp. 118-21.

[29] Ibid., citing Act of June 19, 1952, 66 Stat. 138, 5 U.S.C. 150k, 150k-1 (1952).

## The Profit Producers

Generally, there is an exchange at every military installation. At the larger installations there will be a number of branches and locations for either general merchandise or special lines of merchandise or service. In some instances where there are a number of installations concentrated in one area the exchange operations may be centralized under one senior command. The exchange usually resembles the large modern chain drugstore but there may be significant differences.

The activities of the exchanges are limited by the restrictions of the Armed Services Exchange Regulations. These regulations authorize the following activities:

1. Retail store, for which permissible items and costs are outlined in the regulations;
2. Soda fountain and snack bar;
3. Gasoline filling station;
4. Beer bar;
5. Automobile garage and service station;
6. Restaurant and cafeteria;
7. Barber shop;
8. Beauty parlor;
9. Laundry;
10. Watch repair shop;
11. Tailor shop, including drycleaning and pressing;
12. Shoe repair shop;
13. Photographic studio;
14. Vending and amusement machines;

15. Guest and hostess houses;

16. Recreation rooms;

17. Taxicab and bus services;

18. Newsstands;

19. Recreation and athletic facilities; and

20. Grocery section, when specifically authorized.[30]

The regulations permit service activities to be operated by private concessionaires under contract to the exchange.[31] Typically, such activities might be beauty parlors, laundries, watch repair shops, and photographic studios.

Each service publishes its own regulations for exchanges. Typically, many of the activities which the Secretary of Defense authorized for exchanges are reserved by the service for operation by other nonappropriated fund activities which are either profit consuming or sundry type activities.

The list of merchandise which the exchanges may handle with the cost limitations covers six pages of the Armed Service Exchange Regulations. It includes the general categories of candy and confections, beverages, tobacco and accessories, toiletries and drugs, stationery and supplies, military clothing and accessories, civilian clothing and accessories, jewelry, housewares and accessories, miscellaneous (thirty-five general and specific items), sports and recreational equipment and supplies, and automotive.[32]

Generally, every military installation has a motion picture theater as well as an exchange. Motion pictures are regarded as essential ingredients of

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[30] Armed Services Exchange Regulations, para. 3-101.

[31] Ibid., para. 4-301.

[32] Ibid., para. 3-201.

the free time program of each service. In the Army and the Air Force, motion picture theaters are operated as profit producing activities under the Army and Air Force Motion Picture Service, whereas the Navy and Marine Corps operate their motion picture theaters as part of their profit consuming recreational activities.

The exchanges and the Army and Air Force Motion Picture Service are the big profit producers. Their profits are turned over to the profit-consuming welfare and recreation funds on a centralized or local basis depending on the service.

Actually, "profit" as it is used in this paper, is not the net profit or net income of the private business enterprise. It corresponds to unappropriated earnings in civilian business. The profit producers retain a portion of their income from operations in the form of capital improvements and appropriated reserves. The Army and Air Force actually call the distribution of funds from the exchange and motion picture activities to their welfare funds "dividends." This term probably more nearly describes the payment in terms of private corporate enterprise than "profit."

## The Profit Consumers

The military welfare funds of the Army and Air Force and the recreation funds of the Navy and Marine Corps receive the profits from the profit producing activities, and use these funds for their free time programs.

The use of welfare and recreation funds is generally at the discretion of the local commander. Libraries, crafts and hobby facilities, music and entertainment, service clubs, day rooms, bowling alleys, and other sports both participative and spectator are typical applications. Any activity contributing to the wholesome occupation of free time may be found in the programs of the services.

## The Variations in Systems

One important variation between profit systems among the services, the arrangement for motion pictures, has already been mentioned. There are other important differences. First, there are differences in the organization of the exchanges among the services which bear upon the total picture of the profit system. Second, there are differences in the way profits are gathered and distributed to the profit-consuming activities. These differences are basic to the description of the profit systems which is the objective of this paper. They will be developed in detail in succeeding chapters.

## CHAPTER III

## THE ARMY AND AIR FORCE

The systems of the Army and Air Force are discussed together in this chapter because they share the same profit producing activities, the Army and Air Force Exchange Service and the Army and Air Force Motion Picture Service. Also, their profit consuming activities, the military welfare funds, are quite similar in organization and operation.

Because the Army and Air Force together constitute the largest system and because their profit producing activities most nearly approximate private corporate enterprise, the systems of these services are developed in this chapter as a point of departure and as a basis for comparison in discussing the systems of the Navy and Marine Corps in Chapters IV and V.

### The Army and Air Force Exchange Service

The Army and Air Force Exchange Service fills the exchange role for both the Army and the Air Force. It is one big business operating about 200 exchanges throughout the world. It is the world's third largest retail merchandising business. Sales for fiscal year 1963 will exceed $1 billion and profit will be about $65 million.[1]

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[1]Interview with Mr. Rankin R. Boone, Washington Representative of the Chief, Army and Air Force Exchange Service, February 18, 1963.

## Organization

At the top of the organization of the Exchange Service is the Board of Directors, Army and Air Force Exchange and Motion Picture Services. This body serves for both the Exchange Service and the Motion Picture Service.[2]

The members of the Board of Directors are appointed by the Secretary of the Army and the Secretary of the Air Force. Each service secretary appoints three general officers to the board: one each representing the comptrollership function, the logistics and materiel function, and the personnel function. The chair rotates every three years between the comptroller members of the two services.[3]

The Board of Directors serves a function similar to boards of directors in private corporate enterprise. It selects the Chief and Deputy Chief of the Exchange Service; approves basic plans, policies, and programs; reviews and approves annual financial plans; and makes periodic reviews of operations.[4] Though the Board of Directors are responsible to the Secretary of the Army and the Secretary of the Air Force for these functions, the regulations which govern the Board of Directors State:

> The Chief, Army and Air Force Exchange Service and Chief, Army and Air Force Motion Picture Service functioning for and on behalf of the Board of Directors, are charged with the primary responsibility for worldwide administration of their respective activities.[5]

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[2]U.S., Army and Air Force, Boards, Commissions, and Committees: Board of Directors, Army and Air Force Exchange and Motion Picture Services, Army Regulations No. 15-110, Air Force Regulation No. 147-1, June 18, 1959 and changes, para. 3.

[3]Ibid., para. 2.

[4]Ibid., para. 3.

[5]Ibid., para. 4.

The Chief of the Exchange Service maintains headquarters in New York City. From there he administers the Exchange Service in much the same manner as the president or chief executive of a private corporate enterprise. He does this through the staff of his headquarters, service centers, the command chain of major commanders and local commanders, and the exchange officers of the exchanges. The exchange officers are responsible for the operation of the individual exchanges.

There is a high degree of centralized control of operations and policy making in the Exchange Service. Some of the stated objectives of the Exchange Service have a direct bearing on this characteristic:

> Adequate and substantially uniform exchange services to meet the needs of the Army and the Air Force.
>
> Reasonable profits as are determined necessary . . . for the support of Army and Air Force welfare and recreational programs.
>
> Lowest possible prices substantially uniform worldwide.
>
> Joint Service participation in the use of funds, inventory, personnel, and facilities, and in the organization of operating elements on a geographical basis.
>
> Maximum management efficiency through the application of modern business methods, uniform operational and fiscal controls, and optimum use of combined resources.
>
> Maximum coordination in the provision of procurement, warehousing, inventory control, and distribution services to avoid uneconomical duplication of these activities.[6]

Highly centralized control in the Chief of the Exchange Service and his Headquarters are necessary to meet these objectives.

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[6] U.S., Army and Air Force, Exchange Service: General Policies, Army Regulations No. 60-10, Air Force Regulation No. 147-7, Feb. 27, 1959 and changes, para. 4. Hereafter referred to as AR 60-10 and AFR 147-7.

The Chief of the Exchange Service formulates broad policy and prescribes procedures for budgeting, accounting, reporting, internal auditing, inventory control, technical matters, personnel, procurement, and pricing. He also prescribes profit objectives, conducts the public relations program, conducts inspections and audits, and operates a central insurance program.[7]

The United States is divided geographically into regions, each of which is served by a service center. The centers provide "centralized fiscal accounting, statistical, and record services for payment of invoices and payroll; maintenance or records of accounts; preparation and distribution of financial and statistical reports;"[8] technical specialists; and coordination of civilian personnel administration. These are the regional instruments for administering the chief's control.

Major area commanders are responsible for achieving assigned profit objectives and assigning individual exchange profit objectives. They develop financial plans and budgets, evaluate services, and make recommendations to the Chief of the Exchange Service for exchanges within their commands. Overseas major commanders also provide the centralized service functions furnished by the service centers in the United States.[9]

Exchange officers officially report to local installation or base commanders. According to regulations, the installation or base commander is responsible for achieving service and profit objectives at his exchange.[10] It is

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[7]Ibid., para. 9.

[8]Ibid., para. 10.

[9]Ibid., para. 11.

[10]Ibid., para. 12.

not clear how this is to be accomplished since he is severely restricted in the activities of the exchange, prices, and the disposition of revenue. As a practical matter, it appears that the local commander is limited to determining within limitations the activities required for his exchange, providing space and facilities, setting hours of operation, and overseeing general managerial efficiency through the exchange officer.

## Operations

The Chief of the Exchange Service has control over all the assets of the Exchange Service.[11] One of the most important devices in controlling assets is a centralized banking service for exchanges in the continental United States which permits only limited disbursements on the local level. The great majority of disbursements are made by the service centers.[12]

Procurement of merchandise for resale is done on the local exchange level but through price agreements negotiated by the headquarters. The headquarters itself purchases merchandise originating in the United States for overseas exchanges.[13]

Inventory in local Army and Air Force exchanges is controlled through two devices, budgetary limitations and prescribed stock lists. The budgetary limitations take the form of "open to buy" balances derived from budgetary procedures.[14] Each exchange in the United States derives its basic stock list from

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[11] Ibid., para. 9.b.(3).

[12] Interview with Mr. Rankin R. Boone, Feb. 18, 1963.

[13] U.S., Army and Air Force, Exchange Service: Operating Policies, Army Regulations No. 60-20, Air Force Regulation No. 147-14, Feb. 27, 1959 and changes, para. 75. Hereafter referred to as AR 60-20 and AFR 147-14.

[14] Ibid., para. 74.

A domestic exchange stock list prescribed by the Chief of the Exchange Service.[15]

Prices in Army and Air Force exchanges are determined by retail markup schedules and set sale price directives published by the Chief of the Exchange Service.[16]

Budgetary control in the Exchange Service takes a number of forms. The annual financial plan is generated up through the entire service to meet the financial objectives of the Exchange Service.[17] This plan is closely coordinated with the requirements of the central welfare funds of the Army and Air Force, the activities which receive the profits from the Exchange Service.[18]

Monthly budgets are drawn up at the local exchange level to meet the annual financial plan. These are closely related to the open to buy budgets which are administered by the service centers to control purchases in local exchanges.[19]

Capital budgets are drafted annually for the aquisition or replacement of fixed assets. They are approved by the Chief of the Exchange Service and the Board of Directors.[20]

## Profit Accumulation and Distribution

Profits from the Exchange Service are accumulated through the central

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[15] Ibid., para. 69.

[16] Ibid., para. 67.

[17] Ibid., para. 15.

[18] Interview with Mr. Rankin R. Boone, Feb. 18, 1963.

[19] AR 60-20 and AFR 147-14, para. 16.

[20] Ibid., para. 106.

banking system and the regionally controlled accounting system at the headquarters in fulfillment of budgeted profit objectives.[21] They are distributed to the central welfare funds of the Army and Air Force on a pro rata basis.[22] The basis of this distribution is the military personnel strength of the two services computed on a "present for duty" count that measures the personnel actually on duty at Army and Air Force installations. Currently, the Army receives about 55% of the profits and the Air Force about 45%.[23]

## The Army and Air Force Motion Picture Service

The Army and Air Force Motion Picture Service provides motion pictures to all Army and Air Force installations. This is a vast operation. It includes the display of films at 1785 sites, ranging from 16 mm. films for small groups at small installations to the operation of conventional theaters with hundreds of seats showing 35 mm. films.[24] Attendence at motion pictures shown by the Motion Picture Service was 84.31 million in fiscal year 1962.[25]

As previously explained, the Motion Picture Service shares the same board of directors with the Exchange Service. The organizations are similar in

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[21]Interview with Mr. Rankin R. Boone, Feb. 18, 1963.

[22]AR 60-10 and AFR 147-7, para. 18-19.

[23]Interviews with Lt. Col. Charles C. Helscher, USAF, Executive Secretary, Air Force Welfare Board, March 8, 1963; and Maj. Vaughn H. Baggerly, AGC, USA, Special Services Branch, Adjutant General's Office, Feb. 25, 1963.

[24]U.S., Army and Air Force Motion Picture Service, "Theater Statistics," an unpublished paper from the files of the Army and Air Force Motion Picture Service, Jan. 31, 1963, p. 1.

[25]U.S., Army and Air Force Motion Picture Service, "Briefing - 1963," an unpublished paper from the files of the Army and Air Force Motion Picture Service, 1963, chart No. 10.

other respects. The Motion Picture Service has the same sort of highly centralized policy administering and control apparatus centered in its headquarters in Washington, D.C. It has a system of regional offices and depots which correspond to the service centers of the Exchange Service, but in this case the regional organization is largely a distributive instrument for films and equipment. The fiscal accounting and administrative functions are wholly centered in the Washington headquarters.[26]

If there is any difference between the degree of concentrated control in the Motion Picture Service and the Exchange Service, the Motion Picture Service appears to be themore centralized. There are indications that the Board of Directors take a greater part in policy making in the case of the Motion Picture Service.[27] Further, the nature of the operation dictates that there is less opportunity for operations to be influenced on the local level in the Motion Picture Service.

Operations

The headquarters of the Motion Picture Service contracts for films with commercial film distributors.[28] In so doing, it sets the price which will be charged for admission and the percentage of return to the distributor.[29] The

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[26]Interview with Mr. Herbert Farmer, Comptroller, Army and Air Force Motion Picture Service, March 1, 1963.

[27]U.S., Army and Air Force, Welfare, Recreation, and Morale: Army and Air Force Motion Picture Service, Army Regulations No. 28-62, Air Force Regulation No. 34-32, June 12, 1959 and changes, para. 4. Hereafter referred to as AR 28-62 and AFR 34-32.

[28]Ibid., para. 15.

[29]Interview with Mr. Herbert Farmer.

films are supplied to the regional facilities of the Motion Picture Service through the local distributive offices of the film distributor. The Motion Picture Service then distributes the films to its theaters according to schedules made up on a regional basis.[30]

The admission price for films is either twenty-five cents or forty cents, depending on the Motion Picture Service's agreement with the commercial distributor. Special authority must be gained from the Board of Directors to charge higher admissions in special cases.[31]

There appears to be no budget system within the Motion Picture Service extending out into the field. One is hardly necessary when the main function of the service, the distribution of films, is handled on a centralized basis.

Major commanders and installation commanders have certain responsibilities under the Motion Picture Service, but these are limited to coordination, limiting patronage in accordance with regulations, and providing facilities.[32] Equipment peculiar to displaying films is procured and distributed by the Motion Picture Service through its regional organization.[33]

Gross receipts in the Motion Picture Service have averaged about $20 million per year in recent years. No profit figures are available. The cost of films in fiscal year 1962 was $8.77 million.[34]

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[30]"Briefing - 1963," p. 5.

[31]Interview with Mr. Herbert Farmer.

[32]AR 28-62 and AFR 34-32, para. 5-6.

[33]"Briefing - 1963," pp. 4-5.

[34]Interview with Mr. Herbert Farmer.

Profits from the Motion Picture Service are distributed to the Army and Air Force central welfare funds in exactly the same manner and on the same basis as the Exchange Service.[35]

## Army and Air Force Welfare Funds

The welfare funds of the Army and the Air Force are the consumers of the profits of the Exchange Service and the Motion Picture Service. Welfare funds are not part of an integrated system like the Exchange Service and the Motion Picture Service. They comprise a number of separate entities existing at each level of command, from the departmental level down to individual units of the Army and Air Force. They are joined by provisions of regulations and their common source of funds at the top of the departmental structure, the central welfare funds.

The Army Central Welfare Fund and the Air Force Central Welfare Fund receive the profits of the Exchange Service and the Motion Picture Service. These activities and their counterparts on lower command levels in both services are quite similar. Therefore they will be discussed together, and where there are differences between the services the differences will be pointed out.

The central welfare funds invest receipts from the Exchange Service and Motion Picture Service in Federal Government securities and manage these portfolios to maintain reserves for specified purposes and produce monthly distributions for welfare funds at subordinate levels. In this respect the central welfare funds are like banks or trusts holding funds and disbursing them periodically against established allocations.

The custodian of the Army's central fund has estimated that his fund

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[35] AR 28-62 and AFR 34-32, para. 25.

realizes between $1 million and $1.5 million annually in interest income and gains from trading.[36] Apparently, the Air Force Central Welfare Fund does not trade for short term gain to the same extent as the Army fund.

Distributions are made from both central funds on a per capita basis. The rate of these distributions is subject to change, but customarily they have remained stable over long periods. The Air Force rate ($5.25 per man per quarter in the continental United States, and $9.00 per man per quarter overseas) has been in effect since 1960.[37]

Distributions are made from the central welfare funds down the chain of command through a succession of funds. The Army identifies three levels of subordinate funds: major command funds, central installation funds, and unit funds.[38] The Air Force identifies four such levels: major air command funds, subcommand funds, central base funds, and unit funds.[39]

There are no restrictions on the retention of funds at the intermediate levels of the Army except that central installation funds may have to pay up to $1.50 per man per quarter to unit funds. This is the maximum allowed by regulations. Major commanders may reduce this figure.[40]

In the Air Force, major air command funds are required to make minimum

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[36]Interview with Maj. Vaughn H. Baggerly, AGC, USA.

[37]U.S., Air Force, Nonappropriated Funds: Military Welfare Funds, Air Force Regulation No. 176-2, June 5, 1959 and changes, attachment para. 1. Hereafter referred to as AFR 176-2.

[38]U.S., Army, Nonappropriated Funds and Related Activities: Nonappropriated Military Welfare Funds, Army Regulations No. 230-10, June 4, 1958 and changes, para. 3.

[39]AFR 176-2, para. 1.

[40]Interview with Maj. Vaughn H. Baggerly, AGC, USA.

distributions to subordinate funds. These are $1.50 per man per quarter to central base funds, $2.25 per man per quarter to isolated unit funds not supported by central base funds, and $3.00 per man per quarter to reserve component unit funds.[41] In practice, most major command funds distributed almost all of the distribution received from the central fund.[42]

There are provisions in the regulations of both services for major command and central welfare funds to recapture excess funds on lower levels if it should be necessary. An official of the Army Central Welfare Fund has stated that this has never been done and probably will not be in the future.[43] The Air Force does not seem to be so reluctant to exercise this provision.

Local commanders have wide latitude in the use of welfare funds. Generally, they may be used toward any end that is within the purpose ". . . to provide for the comfort, pleasure, and contentment of military personnel and their dependents and to improve their spiritual, mental, and physical well-being."[44] What restrictions there are do not seem to be important from the standpoint of meeting this objective.

The bulk of the burden for welfare fund programs falls on the central installation or base funds. Here the large recreation and athletic programs take place and here the major recreational facilities such as service clubs, libraries, bowling alleys, and swimming pools are operated. Unit funds support fairly minor programs such as unit parties, decorating day rooms, and purchasing special unit insignia.

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[41] AFR 176-2, attachment para. 1.

[42] Interview with Lt. Col. Charles C. Helscher, USAF.

[43] Interview with Maj. Vaughn H. Baggerly, AGC, USA.

[44] U.S., Air Force, Nonappropriated Funds: Nonappropriated Funds and Related Activities, Air Force Regulation No. 176-1, Sept. 10, 1957 and changes, para. 2.

The regulations of both services permit welfare fund activities to operate revenue producing activities only when it is necessary to cover unusually high costs of operation. In actual practice, the Air Force seems to have a more lenient attitude than the Army toward this type of activity.

There is no real system of budgeting to the departmental level for welfare funds in the Air Force. A budgeting system has been tried in the past, but it was found to be superfluous since subordinate funds seem to have no difficulty operating within the usual distribution rates, and the Exchange Service and Motion Picture Service were able to support requirements adequately. Capital expenditures from nonappropriated welfare funds may be approved by major air commanders for amounts up to $50,000. Above this figure the expenditures are approved by the Air Force Welfare Board on an ad hoc basis.[45]

The Army welfare funds have a detailed budgeting system which calls for the major command funds to assemble projected data for seventeen months in advance once a year. This data covers expected income and expense, projected net worth, and a breakdown of expected expenses. The major command funds must also consider appropriated funds in this process and state how and in what amount they will be used in the welfare program.[46] This does not seem to have much bearing on the distribution which the major command fund receives, therefore it is difficult to see what purpose it serves other than providing general information on how funds will be spent.

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[45]Interview with Lt. Col. Charles C. Helscher, USAF.

[46]U.S. Army, Nonappropriated Funds and Related Activities: Nonappropriated Military Welfare Fund Program, Army Regulations No. 230-12, Dec. 17, 1959 and changes, para. 4.

The regular monthly disbursements are not the only outlays from central welfare funds. The subordinate funds may request special allocations, loans, or grants for unprogrammed or especially large requirements. The central welfare funds maintain reserves for this purpose. The Air Force occasionally makes special distributions to all subordinate welfare funds when receipts from the Exchange Service and the Motion Picture Service exceed requirements.[47]

## Summary

The profit systems of the Army and the Air Force have three important elements, the Army and Air Force Exchange Service and the Army and Air Force Motion Picture Service which are the profit producers; and the numerous funds which are the profit consumers. Figure 1 illustrates the flow of profit and financial relationships among these activities.

The Exchange Service and the Motion Picture Service are highly integrated organizations that have most of the important control over buying, pricing, policy, and procedures at the departmental level. Local commanders are served by these services but have little real influence over their performance. The operations of the Exchange and Motion Picture services are geared to the objectives of providing uniformly low prices, uniform procedures, and an adequate profit on an over-all basis.

The central welfare funds receive the profits of the profit producers and act as a depository for the funds. Distribution to using welfare fund activities is made on a substantially uniform per capita basis.

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[47]Interview with Lt. Col. Charles C. Helscher, USAF.

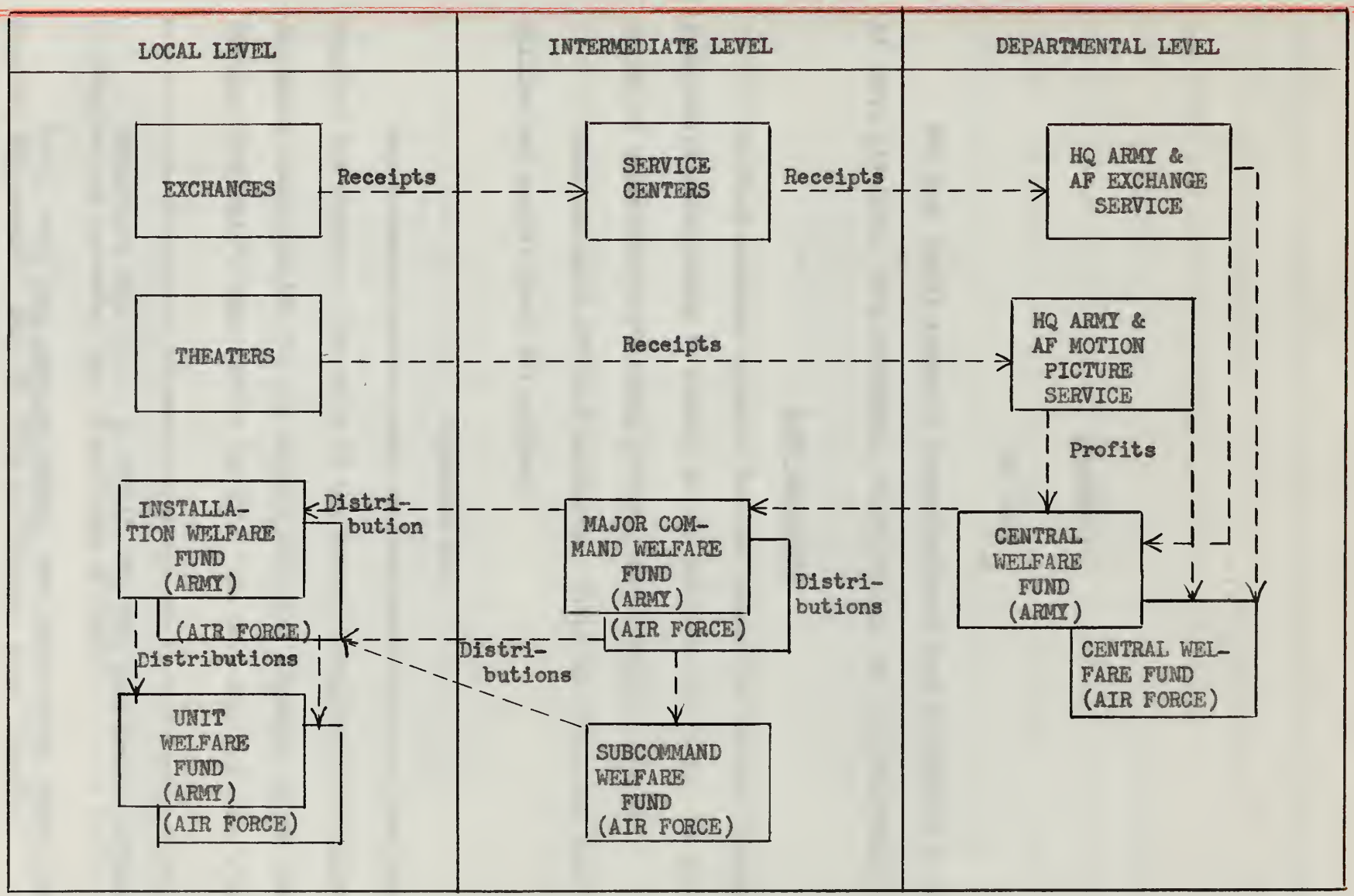


Fig. 1 — Flow of profit and financial relationships among major Army and Air Force nonappropriated fund activities.

## CHAPTER IV

## THE NAVY

The Navy profit system of nonappropriated fund activities is composed of three elements: Navy exchanges, ship's stores, and the recreation funds.

### Navy Exchanges

The Navy exchange system is the one element of the Navy nonappropriated fund profit system which is similar to the Army and Air Force. It has a similar degree of centralized purchasing, pricing, and financial controls.

There are about 175 Navy exchanges. Sales in 1962, were about $294 million and profits about $21 million.[1]

### Organization

Navy exchanges operate under the management control of the Bureau of Supplies and Accounts. The Chief of the Bureau of Supplies and Accounts has delegated responsibility for and control over Navy exchanges to the Commanding Officer, Navy Ship's Store Office (NSSO).[2] The Navy does not have a body with

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[1]Interviews with Lt. N. E. McNeil, SC, USN, Navy Resale Division, Bureau of Supplies and Accounts, Feb. 15 and March 8, 1963.

[2]U.S., Navy, Navy Exchange Manual, Navy Ship's Store Office, Bureau of Supplies and Accounts, Jan. 21, 1954 and changes, para. 1101-02.

authority and responsibilities similar to the Board of Directors of the Army and Air Force Exchange Service. Instead, it has a committee of Navy officers and civilians which acts in a purely advisory capacity.[3]

The Commanding Officer, Navy Ship's Store Office and the Navy Ship's Store Office are the Navy counterparts of the Chief, Army and Air Force Exchange Service and his headquarters. The Navy Ship's Store Office has responsibilities beyond Navy exchanges, as evidenced by the statement of its mission:

> . . . exercises, by delegated authority, management control over Commissary Stores, Navy and Military Sea Transport Service Exchanges, and technical direction over Ship's Stores Afloat to ensure continuing solvency of the Navy Exchange system and its components.[4]

Commissary stores and Military Sea Transport Service exchanges are outside the scope of this paper.

Unlike the Army and Air Force Exchange Service, the mission of Navy exchanges is oriented toward the individual exchange rather than the system as a whole:

> . . . an Exchange is to provide a convenient and reliable source from which authorized patrons may obtain, at the lowest practicable cost, articles and services required for their well-being and contentment; to provide through, profits, a source of funds to be used for the welfare and recreation of naval personnel; and to promote the morale of the command in which it is established through the operation of a well-managed, attractive and serviceable Exchange.[5]

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[3]Robert Stephen Blassic, "Business Budgeting and Practices: Their Application and Use in the Navy Exchange System" (unpublished Master's thesis, School of Government, Business, and International Affairs, The George Washington University, 1961), pp. 16-17.

[4]Navy Exchange Manual, para. 1201.1.

[5]Ibid., para. 1311.

It is noteworthy that the exchange itself is mentioned in this statement as a factor in morale.

The Navy Ship's Store Office controls Navy exchanges as a system, in much the same manner as the Army and Air Force Exchange Service controls Army and Air Force exchanges. There is a distinct difference, however, in the fact that the Navy exchanges do not have a regional organization comparable to the service centers of the Army and Air Force, and that the Navy Ship's Store Office controls more directly the activities of exchanges without the degree of major and local command participation that occurs in the Army and Air Force system. There is a distinction between "management" and "military" control in the Navy that is not present in the Army and the Air Force. Exchanges are under the military control of major and local naval commanders, but they are under the management control of Navy Ship's Store Office. The concepts of these two types of control apparently overlap in the case of exchanges, for regulations make specific provision for a commander to report to the Chief of Bureau of Supplies and Accounts when an exchange is not furnishing service consistent with its mission.[6] Regulations also provide for an exchange officer to report to the Navy Ship's Store Office when command control jeopardizes the best interests of the exchange.[7] As a practical matter, this distinction between military and management control does not appear to effect the operations of exchanges seriously.

## Operations

Navy exchanges operate in substantially the same manner as Army and Air

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[6] Ibid., para. 1103.3.

[7] Ibid., para. 1104.1.

Force exchanges for the purpose of this paper, therefore this section will only describe differences where they exist.

Accounting and reporting are more centrally oriented in the Navy because there are no service centers to handle these matters. There is a centralized banking and accounting system which gives the Navy Ship's Store Office control of financial operations.

Purchasing is controlled by the Navy Ship's Store Office through price agreements with commercial distributors. These agreements are also the vehicle for setting sale prices.[8] In this respect, the Navy has a stated objective of uniform prices similar to that in the Army and Air Force.[9] Navy exchanges are permitted to buy from local sources not covered by price agreements when more favorable prices can be found. In this case, selling price is established by a prescribed pricing formula.[10]

Inventory in Navy exchanges has the same sort of controls as in Army and Air Force exchanges: budgetary control and control by item stock lists. Budgetary controls are called "open to buy" budgets just as in Army and Air Force exchanges. "Open to buy" budgets and their accompanying sales forecasts for each exchange are approved by the Navy Ship's Store Office.[11]

Item stock lists in Navy Exchanges take the form of "never out" lists. These lists prescribe certain items which will always be available in Navy exchanges.[12] They do not control quantity as such but merely dictate that the

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[8]Ibid., para. 4132.1 and 4162.3.

[9]Ibid., para. 4162.2.

[10]Ibid., para. 4162.3.

[11]Ibid., para. 4122-25; also for an analytical discussion of budgeting in Navy exchanges see Blassic, pp. 44-51.

[12]Ibid., para. 4134.1.

items are mandatory. "Never out" lists of the Navy are more general in designating items than are the basic list of the Army and Air Force.

The salient difference between the Navy exchange system and the Army and Air Force system is the difference in the financial status of individual exchanges. In the Army and Air Force, exchanges are financially part of a whole system. Each exchange operates as a part of the system contributing to the total sales, expense, and resulting profit. The headquarters of the Army and Air Force Exchange Service is a part of that system and the expenses of operating it are considered an expense of the whole.

In the Navy, each exchange is treated as an individual financial entity. Each exchange operates within its own financial framework. The total system is only brought together financially at the Navy Ship's Store Office for purposes of working capital management. Each exchange contributes 3% of its average monthly sales to the operation of the Navy Ship's Store Office to maintain a reserve for capital expansion and equipment replacement and acquisition. This assessment is treated as an expense item by the individual exchanges.[13]

## Accumulation and Distribution of Profit

Profits for each exchange are accumulated at the Navy Ship's Store Office through the centralized accounting and banking system. They are distributed back to the recreation fund of the activity where the exchange is located after deduction of a contribution to the Navy Central Recreation Fund. This contribution is based on a scale of average monthly sales ranging from 5% of sales for exchanges with average monthly sales up to $10,000 to 15% of sales for exchanges with average monthly sales over $150,000.[14]

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[13]Interview with Lt. N. E. McNeil, SC, USN, Feb. 15, 1963.

[14]*Ibid.*

## Ship's Stores

Ship's stores are the seagoing exchanges of the Navy. They serve substantially the same purpose as exchanges, but the fact that they are aboard ship limits their merchandise and service. There are about 800 ships with ship's stores. Their sales in fiscal year 1962 were approximately $49.6 million and profits were about $5.3 million.[15]

### Organization

Ship's stores are not a system of stores, rather, each store is a part of the supply department of the ship. It is operated by the supply officer under regulations for the supply system. They actually handle issue clothing as well as merchandise for resale, but there is no profit from clothing therefore it is not within the scope of this paper.

Ship's stores are not subject to the Armed Services Exchange Regulations though the regulations that cover them conform closely to the spirit of the Armed Service Exchange Regulations in prescribing authorized patrons, merchandise, and activities.

The Navy Ship's Store Office exercises technical supervision over ship's stores, but this is a much more detached relationship than the management control it exercises over exchanges.[16] The commanding officer of a ship has a large amount of control over his ship's store.

### Operation

Technically, ship's stores are not nonappropriated fund activities.

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[15]Interview with Lt. N. E. McNeil, SC, USN, March 8, 1963.

[16]Navy Exchange Manual, para. 1201.1.

Their merchandise and services are financed from appropriated funds, however their profits are nonappropriated funds.

Merchandise in ship's stores is part of the Navy Stock Fund Account.[17] It is paid for from the Navy Stock Fund and proceeds from its sale equal to its cost go back into that fund in a manner similar to all sales from revolving appropriated funds. The Navy Ship's Store Office does the necessary budgetary work for the annual funding from the Navy Stock Fund for ship's stores.[18]

Merchandise for ship's stores is procured through Navy supply channels against contracts negotiated by the Navy Ship's Store Office and local supply activities ashore. Individual ships are permitted to go direct to commercial distributors only when normal sources cannot meet their needs.[19] Stocks of merchandise in ship's stores may not exceed the value of expected sales for the next three months.[20]

There is no limitation or mandatory formula for establishing retail prices in ship's stores.[21] The only important limitation in this respect is that ship's stores are permitted to make only 15% profit on sales.[22]

Each ship's store is assessed 1½% of sales from its profit which goes

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[17]U.S., Navy, Bureau of Supplies and Accounts Manual, Vol. III: Supply Afloat, Bureau of Supplies and Accounts, 1946 and changes, para. 39005.

[18]Navy Exchange Manual, para. 1201.2.

[19]Bureau of Supplies and Accounts Manual, para. 39152-55.

[20]Ibid., para. 39111.

[21]Ibid., para. 39510.

[22]Ibid., para. 23351.

to the Navy Ship's Store Office.[23] Two-thirds of this assessment (1% of sales) is retained in the Navy Ship's Store Office to defray administrative expenses and to finance minor ship's store equipment. One-third of the deduction (½% of sales) goes to the Bureau of Naval Personnel Central Recreation Fund. The balance of the profits are available to the ship for its recreation fund.[24]

Accumulation and Distribution of Profits

Financial transactions for ship's stores are handled through regular Navy disbursing channels. Returns consisting of balance sheets and operating statements are made up each quarter to compute the status of the store.[25] Profits after deduction of the assessment of 1½% on sales are conveyed directly to the commanding officer of the ship for the ship's recreation fund by the disbursing officer as a result of these statements.[26]

## Navy Recreation Funds

Navy recreation funds receive the profits of Navy exchanges and ship's stores. The Navy identifies four types of recreation funds: unit funds, composite funds, command funds, and the Bureau of Naval Personnel Central Recreation Fund.[27]

Unit and composite funds are the large end users of profits from the

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[23] Ibid., para. 39350.2.

[24] Interview with Lt. N. E. McNeil, SC, USN, March 8, 1963.

[25] Bureau of Supplies and Accounts Manual, para. 39410-11.

[26] Ibid., para. 39356.

[27] U.S., Navy, Special Services Manual, Bureau of Naval Personnel, 1954 and changes, para. 1120.

exchanges and ship's stores. As previously mentioned, they receive the residue of profits direct from the Navy Ship's Store Office, or the disbursing officer in the case of ship's stores, after deductions for that office and the Central Recreation Fund.

Unit and composite funds do not coexist at the same location. Unit funds are the ". . . Recreation Funds of individual ships, stations, or other independent activities."[28] A composite fund is ". . . a single Recreation Fund intended to serve the need of several activities, grouped in reasonable proximity, particularly where there exists only one set of basic recreational facilities and/or one major source of revenue such as a Navy Exchange."[29]

The major portion of the recreation program is financed by the unit and composite funds in the Navy. As in the Army and Air Force, commanders have wide latitude in using the funds. The main distinction between the Army and Air Force recreation activities and the Navy's activities is in regard to revenue producing activities. Where the Army and Air Force prohibit the operation of revenue producing activities by welfare funds except in unusual cases, the Navy's regulations permit recreation funds to operate activities for revenue.

The Navy does not have a motion picture service filling the role as the Army and Air Force Motion Picture Service, therefore the unit and composite funds ashore in the United States operate their own motion picture theaters as local activities. Admission to motion pictures may be free, or the motion picture theater may operate as a revenue producing activity of the recreation fund at the option of the local commander. There is an arrangement whereby naval district

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[28] Ibid., para. 1210.

[29] Ibid., para. 1310.

commandants provide booking service for Navy and Marine Corps activities within their districts by contact with commercial motion picture distributors, but each activity pay for these films out of its unit or composite recreation fund.[30]

Command recreation funds exist at specified major naval commands such as naval districts, air training commands, force commands, and area commands.[31] These funds receive no direct support from exchanges and ship's stores, therefore major commanders are authorized to assess unit and composite funds within their commands.[32] Command funds exist ". . . for the purpose of facilitating the equalization, distribution, and supervision of Unit and Composite Recreation Funds."[33] Toward this end, they may make loans or grants for recreational purposes with the command.[34]

As mentioned previously in this chapter, the Bureau of Naval Personnel Central Recreation Fund is supported by regular contributions from the profits of Navy exchanges and ship's stores. The Central Recreation Fund may also receive funds by assessment on command, composite, and unit funds; or from the recreation funds of deactivated activities.[35] Central Recreation Fund monies are invested in Federal Government securities just as in the Army and Air Force central welfare funds, but income from investments apparently is not so important in the case of the Navy.

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[30] Ibid., para. 2320.

[31] Ibid., para. 1420 and appendix I-A.

[32] Ibid., para. 1450.

[33] Ibid., para. 1420.

[34] Ibid., para. 1451.

[35] Ibid., para. 1520.

The major application of funds from the Central Recreation Fund is leasing 16mm. motion picture films for free showing aboard ships and ashore at Navy and Marine Corps activities overseas.[36]

This function has received some support from appropriated funds in the past, but recently nonappropriated funds have taken over complete support.[37] The Central Recreation Fund also makes grants and loans to command, composite, and unit recreation funds and makes other expenditures ". . . for recreational projects and/or programs for the general benefit of naval personnel."[38]

There is no budgeting system through the chain of Navy recreation funds. One is hardly needed. A quarterly report is generated up through the chain of commands which indicates the status of working capital in all recreation funds.[39] This report is the basis for any assessments that might be levied by major commands and the Bureau of Naval Personnel. It is the only instrument of financial control over the subordinate recreation funds outside normal command relationships.

## Summary

Figure 2 illustrates the flow of profits and financial relationships among the major Navy nonappropriated fund activities.

The profit producing nonappropriated fund activities of the Navy are the

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[36] Ibid., para. 2210-70.

[37] Interview with Mr. Gerald E. Brislin, Nonappropriated Fund Branch, Bureau of Naval Personnel, Feb. 15, 1963.

[38] Special Services Manual, para. 1540.

[39] Ibid., para. 1470.

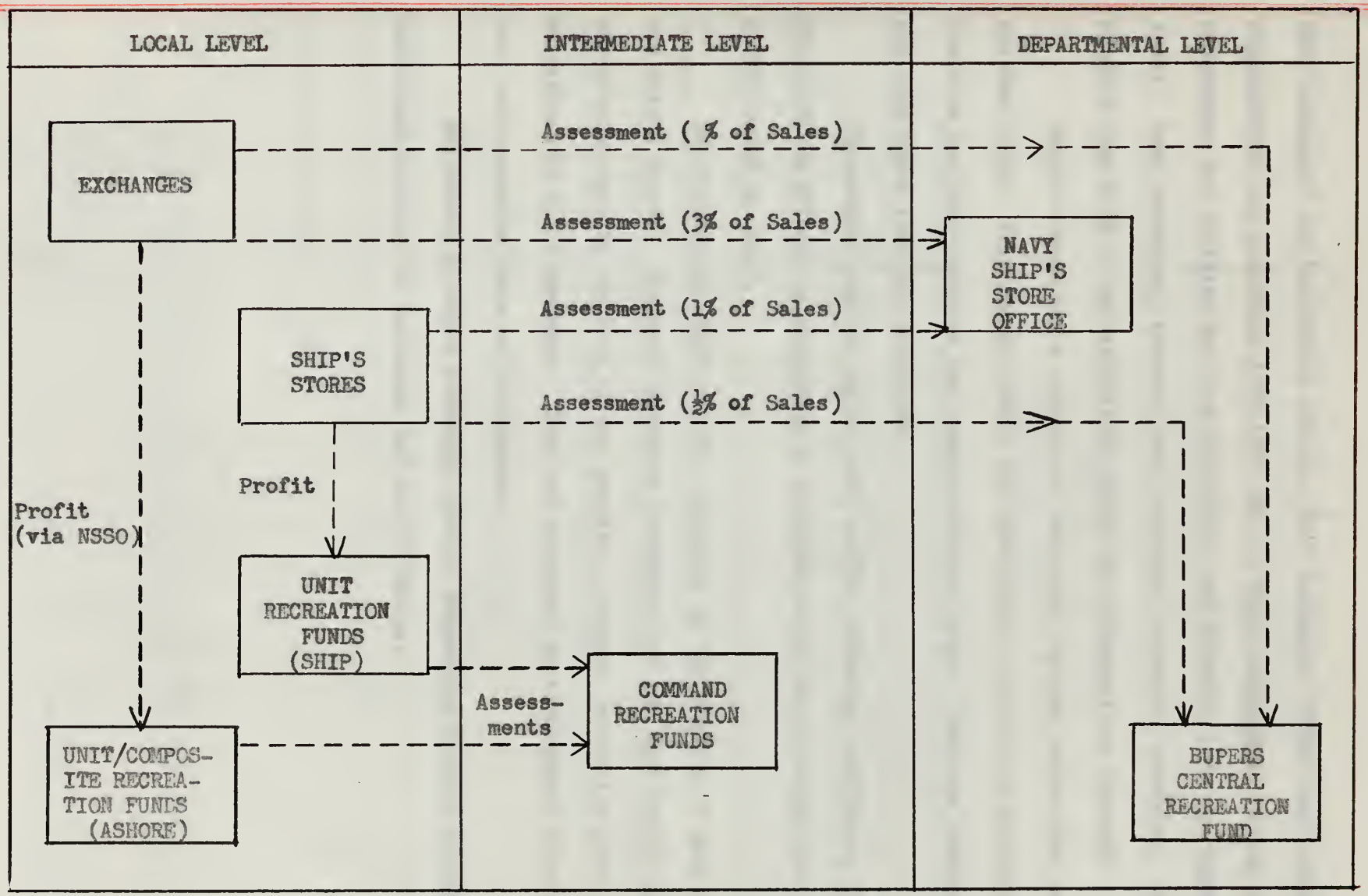
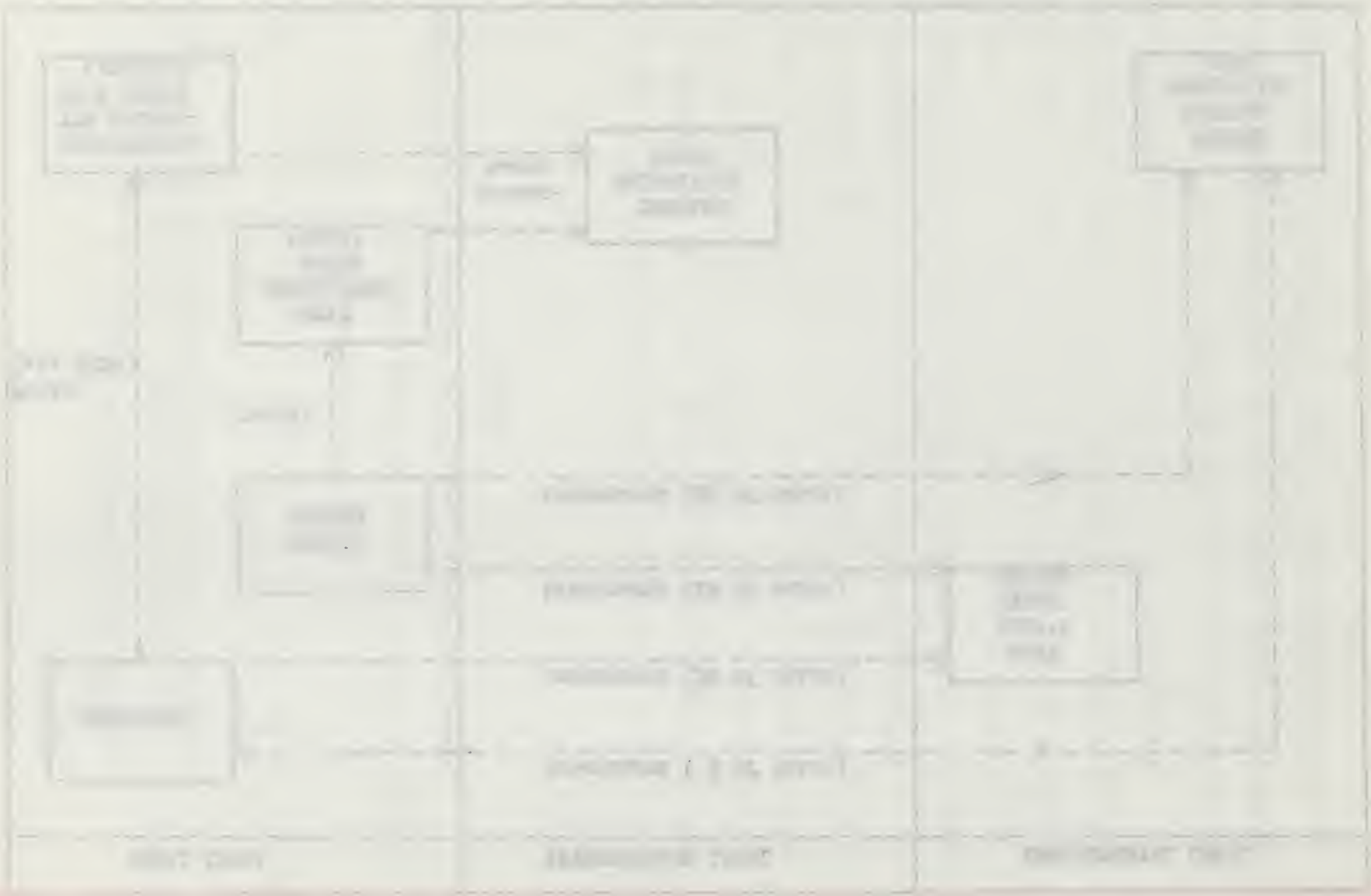



Fig. 2 -- Flow of profit and financial relationships among major Navy nonappropriated fund activities.



Navy exchanges and the ship's stores. Navy exchanges differ only slightly in organization and operation from Army and Air Force exchanges, having uniform procedures and policies that are controlled and directed from the departmental level. Navy exchanges, however, are individual financial entities. Their profits flow back to the activities where the exchanges are located.

Ship's stores are a portion of the supply system rather than nonappropriated funds. They are not under the same central control as exchanges. Profits from the ship's stores are nonappropriated funds. They are retained aboard the ship where they are generated.

The central control agency over profit producing activities, the Navy Ship's Store Office, is supported by assessments on the exchanges and ship's stores based on sales.

The recreation funds are the consumers of the profits of Navy exchanges and ship's stores. The most important consumers are the unit and composite funds which receive the bulk of the profits. Command recreation funds are maintained by major commands. They are supported by assessments placed upon the unit and composite funds of the command.

The Bureau of Naval Personnel Central Recreation Fund is supported by assessment on sales of exchanges and ship's stores.

## CHAPTER V

## THE MARINE CORPS

The Marine Corps profit system in nonappropriated fund activities is the least centralized and most locally oriented of all the services. It is made up of a number of activities on two levels: the local level consisting of individual Marine Corps exchanges and local recreation funds, and on higher levels the command recreation funds, the Marine Corps Exchange Service, the Marine Corps Exchange Fund, and the Central Marine Corps Recreation Fund.

The local activities are the most important from the standpoint of volume of profits and the execution of programs involving profits.

### Marine Corps Exchanges

There are 44 Marine Corps exchanges. In 1962, their sales were $75.9 million and profits were $4.8 million. Exchanges at a few large installations make the bulk of sales. Two of these installations were responsible for over $25 million in sales in 1962.[1]

#### Organization

Marine Corps exchanges are spoken of as a system, but actually they are

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[1]Interview with Lt. Col. A. J. Assad, USMC, Officer in Charge, Marine Corps Exchange Service, Headquarters United States Marine Corps, March 1, 1963.

not a system in the same sense as Army and Air Force exchanges and Navy exchanges. "Their [Marine Corps exchanges] operation is a command responsibility."[2] In this case, the term command refers to local command.

Marine Corps exchanges are established by individual local commands under authority granted by the Commandant of the Marine Corps. The Commandant of the Marine Corps retains a measure of control through his staff agency, the Marine Corps Exchange Service, but this control is substantially the same as in other military matters. The Commandant of the Marine Corps publishes regulations for the operation of exchanges, but these are limited to implementing the Armed Services Exchange Regulations, establishing a uniform accounting system, and providing rather broad policy.

The mission of Marine Corps exchanges is stated as follows:

> The primary purpose of Marine Corps exchanges is to supply to military personnel articles and service necessary for their health, comfort, and convenience at reasonable prices.
>
> The secondary purpose of Marine Corps exchanges is, through reasonable profits, to provide recreation funds.[3]

These objectives are interesting when compared with those of the other services because there is no mention here of uniformity of prices. Also, the objectives of service and profit are definitely assigned an order of importance here.

The local commander in the Marine Corps is ". . . responsible for the general administration of the affairs of the exchange under his command."[4] The

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[2]U.S., Marine Corps, Marine Corps Manual, Headquarters United States Marine Corps, Feb. 14, 1961 and changes, para. 4066.3.

[3]Ibid., para. 4066.2.

[4]U.S., Marine Corps, Marine Corps Exchange Manual, Headquarters United States Marine Corps, July 23, 1962 and changes, para. 1301.

commander appoints an exchange officer to actually operates the exchange.[5] Also, the commander appoints an exchange council which acts in an advisory capacity to the commander in making policy and performs certain functions such as taking physical inventories.[6]

## Operations

Marine Corps exchanges operate very much like independent department stores. In the United States, purchasing is done by the individual exchange. Regulations provide only broad guidelines such as : "merchandise, equipment, and supplies will be procured without favoritism in the open market to best advantage. Only first quality merchandise of known acceptance will be purchased."[7] No restrictions on source or cost are imposed outside those already prescribed in the Armed Services Exchange Regulations. The price agreements published by the Navy Ship's Store Office are recommended to Marine Corps exchanges for information and they may buy from them, but they are not mandatory.[8]

Retail prices charged by Marine Corps exchanges are determined at the discretion of the local exchange. Regulations provide only guidance in pricing: "retail prices shall be established to best accomplish the mission of the exchange. Essential items will be priced to generate the lowest gross profit, and less essential items will be priced to generate higher gross profit."[9]

Inventory control is also left to the local exchange in the Marine Corps.

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[5] Ibid., para. 1302.1.

[6] Ibid., para. 1303.

[7] Ibid., para. 4100.3.a.

[8] Ibid., para. 4101.4.

[9] Ibid., para. 4300.

Regulations provide guidelines which are very general and basic, for example: "purchases of seasonal merchandise will be planned sufficiently in advance to provide for delivery of required initial stocks at the opening of the selling season."[10] Where regulations are specific they are also permissive.

Regulations do impose some minor restrictions on the handling of certain items in exchanges, e.g., pornographic literature, but these are only common sense.[11]

The only substantial control over operations of local exchanges exercised by the Commandant of the Marine Corps is through the financial structure of the exchanges. Regulations specify liberal limits for financial structure:

1. The ratio of current assets (less saving accounts) to total assets (less savings accounts and investments) may not be less than 25% or more than 50%.

2. Total inventories may not be less than 50% or more than 75% of total assets (less savings accounts and investments).

3. The ratio of cash and accounts receivable to current liabilities (acid-test ratio) may not be less than 100%.

4. Reserve for contingencies may not exceed 10% of actual total inventories at cost price.

5. The reserve for equipment and improvements may not exceed 25% of the total original cost of all property less the cost of structures.[12]

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[10] Ibid., para. 4201.2.c.

[11] Ibid., para. 4200.

[12] Ibid., para. 1400.2.

## Accumulation and Distribution of Profit

Profits are accumulated and distributed directly to the local recreation fund by the exchange itself. All profits that have not been appropriated to a reserve or capitalized must be distributed.[13]

## The Marine Corps Exchange Service

The Marine Corps Exchange Service is the staff element of Headquarters Marine Corps that deals with Marine Corps exchanges. Its officer in charge reports to the Quartermaster General who in turn is responsible to the Commandant of the Marine Corps.[14] In its staff capacity, the Marine Corps Exchange Service maintains the regulations for Marine Corps exchanges, reviews inventories, makes staff visits and inspections, and budgets for the Marine Corps Exchange Fund.[15]

The Marine Corps Exchange Fund is the nonappropriated fund financial entity of the Marine Corps Exchange Service. The officer in charge of the Exchange Service is its custodian. The Exchange Fund supports the activities of the Exchange Service and provides funds to the Central Marine Corps Recreation Fund.

In an operational capacity, the Exchange Service fills the following functions:

1. Maintains a general ledger and prepares annual profit and loss statements for the entire system of Marine Corps exchanges from postings supplied by the exchanges. This is a duplication of accounting at local exchanges for purposes of information for Headquarters Marine Corps.

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[13] Ibid., para. 1450.1.

[14] Marine Corps Manual, para. 2066.5.

[15] Marine Corps Exchange Manual, para. 1050.2.

2. Procures standard blank forms and office supplies for exchanges. These items are financed from the Exchange Fund.

3. Administers loans to Marine Corps exchanges from the Exchange Fund.

4. Procures requirements of overseas exchanges for merchandise originating in the United States.[16]

The Marine Corps Exchange Fund is supported by an assessment on the exchanges of 1¼% of net sales of merchandise and certain services. This assessment is treated as an expense by exchanges in determining profit.[17]

## Marine Corps Recreation Funds

The Marine Corps has three types of recreation funds: local funds, command funds, and the Central Marine Corps Recreation Fund.[18]

Local recreation funds receive the profits of Marine Corps exchanges directly. They carry most of the burden of the Marine Corps recreation program. Their operation is much the same as the installation welfare funds of the Army, the base welfare funds of the Air Force, and the unit or composite recreation funds of the Navy.

As in the other services, commanders of Marine Corps installations or units with local recreation funds have a fairly wide latitude in using recreation funds. Quarterly, each local recreation fund makes a report to Headquarters Marine Corps which consists of a reconciliation of cash accounts, a balance sheet, and an income statement.[19] This is the only instrument for financial

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[16] Ibid.

[17] Ibid., para. 1253.

[18] U.S., Marine Corps, Marine Corps Special Services Manual, Headquarters United States Marine Corps, March 14, 1961, para. 2200.02.

[19] Ibid., para. 2600 and 2602.

control between the local recreation funds and Headquarters Marine Corps.

It is Marine Corps policy that activities that can produce profit and are operated for that purpose will come under the exchange. Recreation activities such as motion picture theaters, golf courses, bowling alleys, hostess houses may impose a charge on their patrons, but receipts from these activities should be used only to cover a portion of the cost of operation rather than bring additional revenue into the recreation fund.[20]

Marine Corps activities participate in the same motion picture programs as the Navy. In the United States, motion pictures may be free of admission or they may produce limited revenue. The Marine Corps limits admission which may be charged to 10¢, or 15¢ in special cases with the approval of the Commandant of the Marine Corps.[21]

Marine Corps regulations permit command recreation funds only at two major commands: Fleet Marine Force, Pacific and Fleet Marine Force, Atlantic. These funds are supported on a budgeted basis from the Central Marine Corps Recreation Fund. Their purpose is to administer major command recreation programs which supplement local programs.[22]

The Central Marine Corps Recreation Fund is administered by the staff of Headquarters Marine Corps for the Commandant of the Marine Corps. It receives its funds from the Marine Corps Exchange Fund based on a budget approved by a board acting for the Commandant of the Marine Corps.[23] This fund fills a number

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[20]Interview with Major R. J. Randolph, USMC, Special Services Branch, Personnel Department, Headquarters United States Marine Corps, April 16, 1963.

[21]Marine Corps Special Services Manual, para. 4105.

[22]Ibid., para. 2201.

[23]Marine Corps Manual, para. 7010.5; and Marine Corps Exchange Manual, para. 1104 and 1151.

of functions, the most important of which follow:

1. provides financial assistance to other recreation funds in the form of loans or grants,

2. maintains a reserve of funds to provide a nucleus of money to form new recreation funds in deploying combatant units,

3. maintains a reserve of funds to finance construction of athletic and recreation facilities when appropriated and local nonappropriated funds are not available,

4. supports recreation programs at certain small units which do not have exchanges to support them, and

5. supports certain Marine Corps-wide athletic and recreation programs.[24]

Central Marine Corps Recreation Fund monies are invested in savings accounts and Federal Government securities just as in comparable funds in the Army, Air Force and Navy. Income from these investments is probably negligible since the total assets of the fund on January 31, 1963 were only $1.35 million.[25]

## Summary

Figure 3 illustrates the flow of profits and the financial relationships among major Marine Corps nonappropriated fund activities.

The Marine Corps system for profit in nonappropriated fund activities is highly decentralized. More accurately, it might be said that control of these activities was never centralized when the other services centralized during and

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[24] Marine Corps Special Services Manual, para. 2200; and interview with Major R. J. Randolph, USMC, March 1, 1963.

[25] Interview with Major R. J. Randolph, USMC, March 1, 1963.

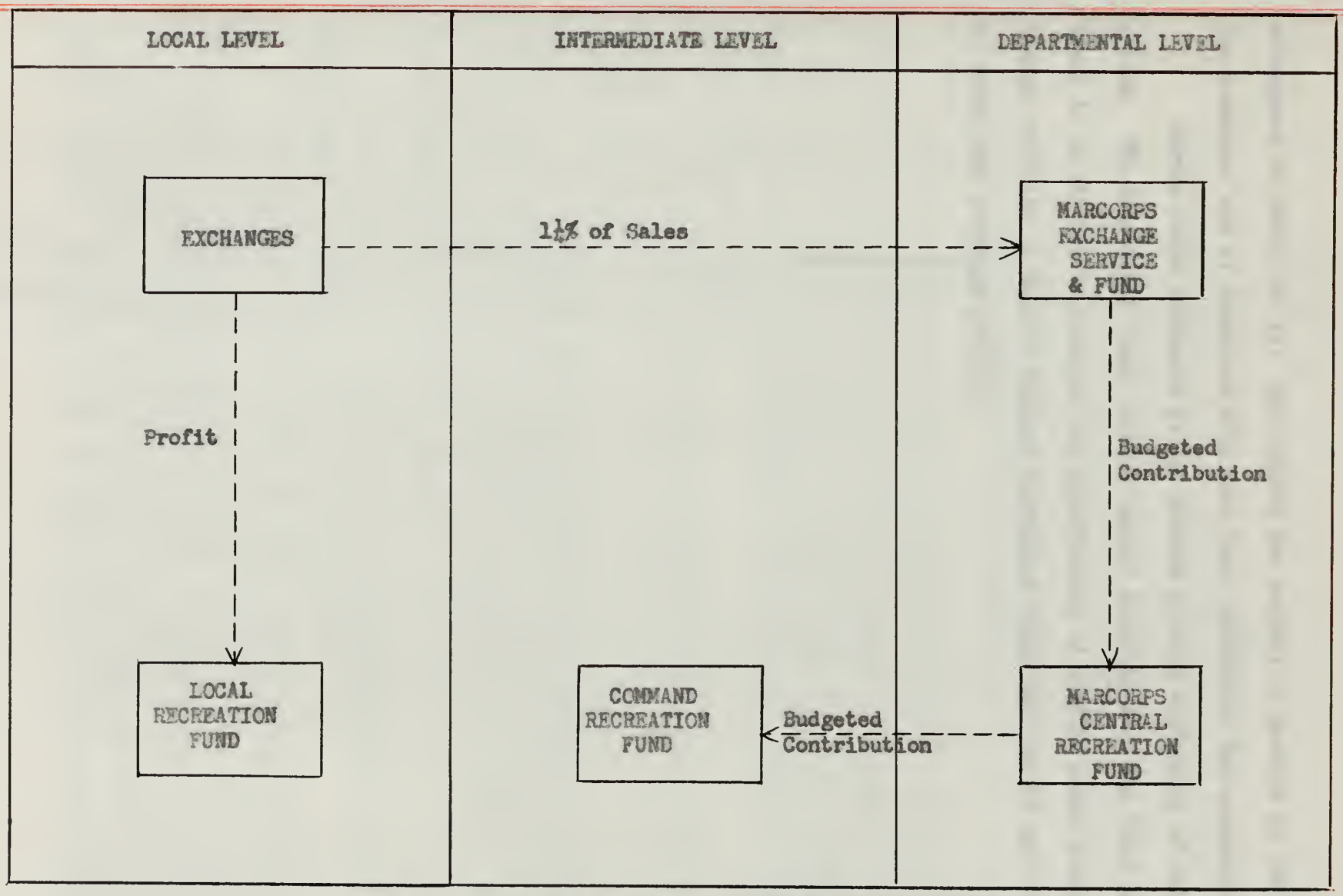


Fig. 3 -- Flow of profit and financial relationships among major Marine Corps nonappropriated fund activities.

subsequent to World War II. This leaves the control of profits in the hands of the commander who is concerned with both their production and consumption.

Marine Corps exchanges do not attempt to have uniformity of selling prices. The recreation funds receive support directly from the local exchange. There is no attempt to equalize the distribution of profits among local funds though provision is made to support recreation funds that do not have a source of funds from exchange profits.

## CHAPTER VI

## EVALUATION AND CONCLUSIONS

The profit systems of military nonappropriated fund activities begin with activities that sell goods and services to military personnel, and in the process receive revenue above cost. The profit thus created is distributed to welfare and recreation activities where it is used in programs for the general good of military personnel.

The chief differences among the systems of the various services lie in the following areas:

1. The important decision making powers that influence the size of profit in the profit producing activities, e.g., source of merchandise, size of inventory, retail prices, and retention of earnings, are vested in different levels of authority in different systems.

2. The methods of accumulating and distributing profits to the final profit consuming activities differ among the systems.

The Army and Air Force share the same profit producing activities. The important decision making characteristics as to profit are vested in highly centralized bodies at the departmental level. This structure is necessary to fulfill the objectives of uniform prices, uniform levels of service, and integrated practice. The local profit producing activities and their over-all

administrative structures are integrated financially so that profits are determined on a system basis.

The profit consuming systems of the Army and Air Force are so much alike that they can be discussed generally as if they were one. The two systems share in profits from their common sources on a pro rata personnel strength basis. Profits are held at the departmental level where they are invested and subsequently distributed periodically to lower level activities on a uniform per capita basis.

Lower level commanders in the Army and Air Force are technically responsible for profits at some local profit producing activities (exchanges). It is difficult to see how they can be held to a substantial degree of responsibility when they are not given authority over the important factors that influence profit. From this standpoint, it would seem that the Army and Air Force system is open to criticism. Also, Army and Air Force commanders are responsible for the effectiveness of the welfare programs operated by the local profit consuming activities, but they have little control over the input of resources which support them. This is not a serious inconsistency, however, for it conforms to the general pattern of funding in the Federal Government. In all other respects, the profit systems of the Army and Air Force seem to meet worthy objectives of uniformity in prices and services, and uniform distribution of profits. These objectives probably are in the public interest.

One characteristic of the Army and Air Force system which is not present in such a high degree in the other services is the facility for accumulating funds at a central pint for gainful investment. This characteristic is desirable from the standpoint of efficient use of funds because it unquestionably produces revenue.

The Marine Corps profit system in nonappropriated fund activities lies at the other end of the spectrum from the Army and Air Force system. Marine Corps profit producing activities are essentially locally operated businesses. Control from the departmental level is in the form of broad guidelines. The important factors influencing profit are under the control of the local commander. Profits are transferred directly from the profit producer to the profit consumer at the local level, where both activities are the responsibility of the local commander. Keeping responsibility and authority closely aligned in this manner is undoubtedly a desirable characteristic.

The Marine Corps system is strong where the Army and Air Force system is weak -- in the alignment of authority with responsibility; however, the Marine Corps is weak where the Army and Air Force are strong. Assuming that uniformity in prices, service, and profits are desirable and in the public interest, the Marine Corps is open to criticism. Though there is no evidence that this is a serious problem in the Marine Corps, undoubtedly there are variations in prices, service, and recreational facilities between different Marine Corps installations due to differences in policy at local commands. It is not evident whether there are serious deficiencies in recreation programs where profit producing activities are small or inefficient. There is machinery to reinforce recreation programs on a small scale, but the system is not designed to produce equal benefit from profits throughout the Marine Corps.

The Marine Corps can be criticized in one other respect. It fails to provide a centralized depository for idle funds to insure their efficient investment and thus maximize revenue to recreation programs.

The Navy profit system in nonappropriated fund activities lies somewhere between the Army and Air Force system and the Marine Corps system. It has

elements that resemble portions of both these systems.

The Navy has two essentially different profit producing activities, the exchanges and ship's stores. Navy exchanges most nearly resemble the profit producing activities of the Army and Air Force in that there is a high degree of centralization of important decision making power which influences the size of profit. In ship's stores, there is a lesser degree of this concentration, the ship's commander having the authority to influence profit in at least one important respect. The important difference between these activities is in the control over the establishment of retail prices. Navy exchanges must conform to established prices or prescribed formulas, whereas ship's stores may set their own prices so that their operations come within liberal over-all profit limitations.

The profit producing portion of the Navy system seems incongruous when it is matched with the profit consuming portion. The profits of Navy exchanges and ship's stores flow directly back to the counterpart profit consuming activities at the location of the exchange or ship's store without the leveling of per capita distribution as in the Army and Air Force. Thus, a Navy commander is faced with receiving income for his recreation fund based upon the profits of an activity (especially exchanges) over which he has little real control. The Navy system aims at uniform prices and services in its exchanges, but abandons this line of reasoning in distributing profits directly back to the installation which created them.

The objective of uniform prices and service in profit producing activities is probably in the public interest, but in the Navy's case this has not been matched with the uniform distribution of profit. This incongruity leaves the Navy open to some of the same criticism that can be leveled at the Marine

Corps. As in the case of the Marine Corps, the Navy has the capability to remedy inequalities in profit distribution on an ad hoc basis through grants and loans from its central recreation fund.

The Navy can also be criticized for separating the authority over revenue from the responsibility of applying profits to a recreation program. In this respect, it is noteworthy that the Navy does not charge the local commander with responsibility for profits in exchanges as does the Army and Air Force. Of course, the disparity between authority and responsibility is lessened in the case of ship's stores where commanders have a greater degree of control over profits than with exchanges.

The Navy may be criticized, just as the Marine Corps, in failing to provide a central fund where idle resources may be invested with maximum efficiency.

This paper has described the three profit systems of nonappropriated fund activities which exist in the Armed Forces. The basic question as to which of these systems is best remains unanswered because each service operates in a manner that makes it difficult to compare its system with the others. Despite these differences in operation and the differing philosophies which seem to be behind them, there is a remarkable similarity in the services which the profit system activities provide. The casual observer going from and Army post to a Marine Corps installation, for example, probably would never suspect that the Marine Corps exchange is essentially a local business and the local recreation fund is supported entirely by the exchange.

The profit systems furnish essential goods and services to military personnel and in the process make annual profits of about $100 million.[1] These

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[1]Army and Air Force Exchange Service, $65 million; Navy exchanges, $21 million; Marine Corps exchanges, $4.8 million; ship's stores, $5.3 million; Army and Air Force Motion Picture Service $5 million (estimated). From figures stated in previous chapters.

profits are used to support programs which would have to be supported in large measure by appropriated funds were it not for the profit systems.

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